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IN THE
Supreme Court of the United States

October Term, 1979

No. **79-660**

THE DUPLAN CORPORATION, ET AL., *Cross-Petitioners*,

v.

DEERING MILLIKEN, INC., DEERING MILLIKEN RESEARCH CORPORATION, MOULINAGE ET RETORDERIE DE CHAVANOS, ATELIERS ROANNAIS DE CONSTRUCTIONS TEXTILES, and ARCT, INCORPORATED, *Cross-Respondents*.

**CONDITIONAL CROSS-PETITION FOR A WRIT OF
CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE FOURTH CIRCUIT**

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**CONDITIONAL CROSS-PETITION FOR A WRIT OF
CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE FOURTH CIRCUIT**

This petition is a conditional cross-petition in that cross-petitioners¹ pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit entered in this proceeding on March 26, 1979 (insofar as that judgment and opinion is adverse to cross-petitioners) only in the event that this Court should grant the petitions for a writ of certiorari filed herein by cross-respondents in Nos. 76-644, 76-658, and 76-659 (collectively the "Cross-Respondents' Petitions").

¹ The Duplan Corporation, Burlington Industries, Inc., Dixie Yarns, Inc., Frank Ix & Sons Virginia Corp., Hemmerich Industries, Inc., Jonathan Logan, Inc., Lawrence Texturing Corp., Leon-Ferenbach, Inc., Madison Throwing Co., National Spinning Company, Inc., Reliable Silk Dyeing Co., Inc., Schwarzenbach-Huber Co., Spring-Tex, Inc., Texelastic Corporation, Texfi Industries, Inc., United Merchants & Manufacturers, Inc.

OPINIONS BELOW

The opinion of the Court of Appeals, dated March 26, 1979, is reported at 594 F.2d 979. The opinion of the District Court for the District of South Carolina, dated July 29, 1977, is reported at 444 F. Supp. 648. It is cross-petitioners' understanding that these opinions are set forth in the Joint Appendix being filed with Cross-Respondents' Petitions herein.

JURISDICTION

The judgment of the Court of Appeals for the Fourth Circuit was entered on March 26, 1979. Petitions for rehearing filed by cross-respondents were denied on May 29, 1979. By orders dated August 21, 1979 and September 21, 1979, Mr. Chief Justice Burger granted extensions of time within which to file petitions for certiorari herein up to and including first September 26, 1979 and then October 22, 1979. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Is the applicability of the "exhaustion" doctrine—that manufacture and sale of an article by an authorized patent licensee leaves the article sold free from the exclusionary force of licensed patents purportedly embodied in the article—dependent upon findings of fact as to whether the patentee and his licensees *intended* to relinquish control over the article?

2. May the exclusionary rights of manufacture, use and sale created by the patent law be separately exploited to require the payment of a second royalty for the right to use an article purportedly embodying patents, after payment to the patentee from its exclusive manufacturing and selling licensee of a full patent royalty on the same article?

3. Does this Court's decision in *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175 (1938),

aff'd on rehearing, 305 U.S. 124 (1938), allow a patentee to assert an exclusionary use right, under patents purportedly embodied in an article, against that article when it is purchased from a manufacturer who is authorized by the patentee to make and sell the article, and, if so, should that decision be explicitly overruled in light of other decisions in which this Court has repeatedly held an article to be free from patent restrictions under such circumstances?

4. Is it a violation of the Sherman Act for a patentee, with respect to its foreign and interstate transactions, to combine with (i) its manufacturing-selling licensee of articles, (ii) its "use licensee" of the patents and other unpatented technology purportedly embodied in such articles, and (iii) a reseller of the articles for the purpose of exploiting the patents by imposing upon purchasers of the articles a condition that they agree to pay, in order to obtain delivery of the articles, a total consideration for the normal emoluments of ownership which includes both an initial purchase price paid to the reseller and production payments subsequently imposed by the "use licensee," particularly where that combination is furthered by the operation of a sweeping grant-back provision pursuant to which many of the patents were assigned to the patentee by its manufacturing-selling licensee and by the use of a non-negotiable royalty agreement which tied together in a single package patents (whether or not applicable to the articles) and unpatented technology?

STATUTORY PROVISIONS INVOLVED

United States Code, Title 15:

§ 1. *Trusts, etc., in restraint of trade illegal; penalty*

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal

United States Code, Title 35:

§ 154. *Contents and term of patent*

Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, for the term of seventeen years, subject to the payment of issue fees as provided for in this title, of the right to exclude others from making, using, or selling the invention throughout the United States, referring to the specification for the particulars thereof

§ 261. *Ownership; assignment*

Subject to the provisions of this title, patents shall have the attributes of personal property.

Applications for patent, patents, or any interest therein, shall be assignable in law by an instrument in writing. The applicant, patentee, or his assigns or legal representatives may in like manner grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States.

* * *

STATEMENT OF THE CASE

This litigation consists of 32 separate patent and anti-trust actions instituted in various federal forums but consolidated in the United States District Court for the District of South Carolina by transfers pursuant to 28 U.S.C. § 1404. The jurisdiction of the District Court is invoked under 15 U.S.C. § 15 and 28 U.S.C. §§ 1331, 1332, 1337 and 1338.

Parties

Cross-petitioners (sometimes hereinafter referred to as "Throwsters") produce yarn by texturing synthetic fila-

ments such as nylon and polyester on false twist machines.² Cross-respondent Moulinage et Retorderie de Chavanoz ("Chavanoz"), a French corporation, is the owner of 22 patents (the "patents in suit") relating to alleged improvements in false twist machines and in the false twist process. Chavanoz has granted to Ateliers Roannais de Constructions Textiles ("ARCT-France"), a French manufacturer of textile machinery, an exclusive, world-wide license to make and sell false twist machines under the patents in suit.

Since 1959, ARCT-France has sold false twist machines manufactured under the exclusive license from Chavanoz to its United States distributors. The exclusive United States distributor of such machines since 1966 has been cross-respondent ARCT, Incorporated ("ARCT, Inc."), a North Carolina corporation, which purchased the machines from ARCT-France and resold them to United States yarn manufacturers, including the Throwsters.³

Chavanoz has purportedly granted to cross-respondent Deering Milliken Research Corporation ("DMRC") the exclusive right to use in the United States false twist machines embodying the improvements claimed in the patents in suit. DMRC, in concert with the other cross-respondents, required the Throwsters to sign a standard, printed form production royalty agreement, under all of the patents in suit,⁴ in order to obtain delivery of the false twist machines that they had purchased from Whitin or ARCT, Inc.

² A detailed explanation of yarn texturing in general and false twist texturing in particular appears as Appendix A to the opinion of the District Court.

³ From 1959 through 1965, ARCT-France's exclusive United States distributor was Whitin Machine Works ("Whitin"), which is not a party to this litigation. Like its successor, ARCT, Inc., Whitin purchased machines from ARCT-France and resold them to United States yarn manufacturers.

⁴ Patents not yet in existence at the time a particular Throwster signed the agreement were automatically and unilaterally added to the agreement by DMRC.

DMRC is a wholly-owned subsidiary of cross-respondent Deering Milliken, Inc. ("DMI"), a Delaware corporation. The District Court found that DMRC is the agent, instrumentality, and alter ego of DMI and, based on that finding, concluded that DMI is liable for the acts of DMRC.

Proceedings Below

In the proceedings below, the parties presented three distinct, but interrelated, categories of claims: (1) patent claims, (2) horizontal antitrust claims, and (3) vertical antitrust claims. This cross-petition relates primarily to the vertical antitrust claims, which are based on the distribution system established and enforced by cross-respondents whereunder machine purchasers were required to sign a production royalty agreement in order to obtain delivery of their machines. To underscore the importance of that distribution system to cross-respondents' entire licensing program, we begin with a brief discussion of the patent claims and horizontal antitrust claims.

1. Patent Claims

Chavanoz and DMRC asserted all 22 of the patents in suit in this litigation despite their knowledge, at least as early as 1963, that most were never employed in false twist machines used by the Throwsters. Fourteen of these patents were so clearly inapplicable or invalid that they were dropped or eliminated by pretrial summary judgment orders; the remaining eight were held invalid or not infringed or both invalid and not infringed after trial on the merits. In addition, the District Court found that all of the patents have been misused and are, therefore, unenforceable. All of these holdings were affirmed by the Court of Appeals for the Fourth Circuit.

2. Horizontal Antitrust Claims

Prior to the commencement of this litigation, virtually the entire United States market in false twist machines was

shared by cross-respondents and Leeson Corporation ("Leesona"), a United States manufacturer of false twist and other textile machinery. Leesona was the owner of patents relating to false twist machines and processes and, like cross-respondents, required purchasers of its machines to sign a license imposing production royalties on each pound of yarn processed on the machines.

These parallel production royalty programs existed under the umbrella of a series of agreements entered into in 1964. Although the agreements were entered into in the context of settling litigation, the Throwsters contended, and the District Court found, that Chavanoz and DMRC and Leesona had implicitly agreed to stabilize and maintain production royalty rates and that the dominant purpose of the settlement was anticompetitive. 444 F.Supp. at 681-83. Based on its findings, the District Court concluded that Chavanoz and DMRC had violated Sections 1 and 2 of the Sherman Act with resulting damage to the business and property of the Throwsters.⁵

The Court of Appeals affirmed these holdings. In addition, the Court of Appeals held that the District Court had erred in dismissing the Throwsters' horizontal antitrust claims against ARCT-France and ARCT, Inc.:

The District Court found that the 1964 settlement agreement was the core of a scheme to stabilize and maintain production royalties on false twist machines and to monopolize the United States market for these machines The royalty system, which depended upon the restriction of machine deliveries to DMRC use licensees, could not have been maintained without the active co-operation of ARCT-France and ARCT, Inc.

594 F.2d at 981-82. The restriction on machine deliveries, upon which the Court of Appeals relied, is the primary

⁵ Issues of amount of damages, costs, and attorneys' fees were reserved for a later trial.

basis for the vertical antitrust claims which are the subject of this cross-petition.

3. Vertical Antitrust Claims

The vertical antitrust claims asserted by the Throwsters are based upon cross-respondents' system for distributing false twist machines in the United States. Pursuant to that system, the Throwsters, upon seeking to obtain delivery of a false twist machine manufactured by ARCT-France under its exclusive license from Chavanoz to make and sell, were required to sign a license calling for payment to DMRC of royalties measured by the quantity of yarn produced on the machine. This requirement was effectuated by a restraint imposed upon resellers ARCT, Inc., and its predecessor in function, Whitin, the exclusive United States distributors of the machines. The amount of the royalties was staggering. Over the useful life of a single machine, these royalties on its production could be expected to exceed, or even double or triple, a Throwster's initial outlay for the machine.

The relevant facts, as found by the District Court, may be simply stated:

a. Chavanoz initially licensed ARCT-France to make and sell machines embodying certain patents and subsequent improvements and later licensed DMRC to use such machines (with the right to sublicense). 444 F. Supp. at 661-62.

b. The license to ARCT-France was a full, unrestricted grant of the "exclusive right to manufacture and sell." *Id.*

c. In various agreements, ARCT-France covenanted to limit its sales: initially to holders of a so-called Helanca process license from Heberlein & Co., A.G., a Swiss textile machinery manufacturer, and later to holders of a process license granted by Chavanoz. This restrictive covenant was never confined, or in-

deed even directed, to machines that actually embodied Chavanoz's patents. *Id.*

d. ARCT-France sold its false twist machines outright to its United States distributors and those distributors resold such machines to the Throwsters.⁶ However, pursuant to agreements among cross-respondents, the distributors were restricted from completing their sales, by delivering and installing the machines, unless the Throwster had signed a standard DMRC production royalty agreement. 444 F. Supp. at 664-68.

e. ARCT-France paid Chavanoz a full royalty for every machine it manufactured and sold, that royalty being no less for machines sold into the United States, where machine purchasers were required to pay a production royalty, than for machines sold into countries where no production royalty program existed. 444 F. Supp. at 663.

It is the Throwsters' position that the fully authorized sale of machines by ARCT-France to its United States distributor, and the subsequent resale of those machines by the distributor to the Throwster, exhausted the patent monopoly and conferred upon the Throwster a license, implied in law, to use the machines, so that any attempt to restrict delivery or to confine use of the machines after that sale was unprotected by any of the patents in suit and was in all respects subject to the antitrust laws. The restrictive arrangements among cross-respondents, particularly in the absence of any justification provided by the

⁶ There was, at least prior to commencement of this litigation, no provision in any written purchase agreement which the Throwsters signed with Whitin or ARCT, Inc. that either referred to the standard DMRC royalty agreement or purported to restrict the use of the machines sold under the purchase agreement or that reflected any restriction whatsoever on the right to obtain delivery of those machines.

patent law, the Throwsters contend, unreasonably restrained trade in violation of Sherman Act § 1.

The District Court rejected the Throwsters' contention on the grounds that cross-respondents did not intend that ARCT-France or its distributors would have the right to use the machines, that the purchasing Throwster knew that an attempt had been made to reserve use rights, and that under such circumstances the license to ARCT-France must be deemed to convey only a limited license, with the further result that the sales to Throwsters were deemed conditional despite their unequivocal terms. In reaching its conclusion, the District Court relied upon the general principle of contract construction that the intention of the parties is controlling. Based upon that conclusion, the District Court held:

Since ARCT-France's right to manufacture and sell the machines was a contractually-limited one, the use rights were effectively reserved and Chavanoz and DMRC had the right to license the use of the machines separately from their manufacture and sale, *Brulotte v. Thys Company*, 379 U.S. 29, 85 S.Ct. 176, 13 L.Ed. 2d 99 (1964); *General Talking Pictures Corporation v. Western Electric Company*, 304 U.S. 175, 58 S. Ct. 849, 82 L.Ed. 1273 (1938); *In Re Yarn Processing Patent Validity Litigation*, 541 F.2d 1127 (5th Cir. 1976); *Extractol Process, Ltd. v. Hiram Walker & Sons, Inc.*, 153 F.2d 264 (7th Cir. 1946).

444 F. Supp. at 671. In light of its ruling that the patent monopoly had not been exhausted, the District Court then went on to reject the Throwsters' antitrust claims based upon cross-respondents' delivery restraint. That ruling was also the basis of the District Court's rejection of the Throwsters' contention that cross-respondents engaged in vertical price-fixing by requiring the Throwsters to pay a fixed production royalty to DMRC in addition to the initial

purchase price to Whitin or ARCT, Inc. in order to obtain delivery of machines.

In addition to these claims, the Throwsters advanced two other vertical antitrust claims which were not dependent upon the District Court's disposition of the exhaustion question. They contended that the standard DMRC royalty agreement—which the District Court found was non-negotiable—constituted a *per se* illegal tying arrangement in that it tied machines, patents (whether or not applicable to the machines) and technical information into a single, compulsory package. They also asserted that an assignment grant-back provision in the agreements between Chavanoz and ARCT-France—pursuant to which a majority of the patents in suit were assigned by ARCT-France to Chavanoz and included in the standard DMRC royalty agreement—constituted an unreasonable restraint of trade.

While the District Court did find that the mandatory package licensing practices of Chavanoz and DMRC constituted patent misuse, it rejected the Throwsters' antitrust tying claim on the ground that the Throwsters failed to demonstrate the existence of a separate market in the tied product. Although likewise finding the operation of the grant-back provision to be a patent misuse, the District Court held it did not rise to the level of an antitrust violation.

The Throwsters appealed all the foregoing holdings on the vertical antitrust issues, but the Court of Appeals for the Fourth Circuit affirmed.

REASONS FOR GRANTING THE WRIT

In deciding the patent claims and the horizontal antitrust claims, the courts below applied well-established principles of patent and antitrust law to detailed findings of

fact made by the district judge after a 91-day trial. Since the petitions which cross-respondents will file herein will undoubtedly ask this Court to review the disposition of these factually oriented claims, they do not present the kinds of issues normally considered by this Court on certiorari.

The Throwsters have not filed an independent petition for certiorari with respect to the vertical antitrust issues because those issues are not of controlling significance in view of the finding of liability on the horizontal antitrust issues. Nevertheless, if this Court should grant either of Cross-Respondents' Petitions, the Throwsters respectfully request that the Court also grant this petition. As noted above, the Court of Appeals held that enforcement of the delivery restraint, which is a fundamental premise for the questions presented in this petition, was essential to the maintenance of cross-respondents' royalty system. 594 F.2d at 981-82. Thus, if the horizontal antitrust claims are considered by this Court, an analysis of the delivery restraint will necessarily be required and that analysis should include a determination whether, as the Throwsters have urged, the delivery restraint and cross-respondents' licensing practices related thereto constitute a separate and distinct violation of Section 1 of the Sherman Act.

Moreover, as discussed below, this petition presents important questions (see pp. 2-3, *supra*) concerning (1) the scope of a patentee's exclusionary rights of manufacture, sale and use, (2) the precedential scope and continuing vitality of this Court's decision in *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175 (1938), *aff'd on rehearing*, 305 U.S. 124 (1938), which was relied upon by the District Court, and (3) the application of the antitrust laws to a contractual system constructed by a patentee and its licensees whereunder purchasers of a patented article were forced to sign agreements calling for payment of production royalties, not because of any voluntary desire

to obtain use of patented technology or because of a need for a license, but simply because the purchased article would not be delivered in the absence of an executed license agreement. Central to each of these questions is the conflict between the decisions below and the decisions of this Court in *Aro Manufacturing Co. v. Convertible Top Replacement Co.*, 377 U.S. 476 (1964) ("*Aro*"); *United States v. Univis Lens Co.*, 316 U.S. 241 (1942) ("*Univis*"); *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917) ("*Motion Picture Patents*"); and *Adams v. Burke*, 84 U.S. (17 Wall.) 453 (1873).

The fourth question presented by this petition (p. 3, *supra*) also raises important points concerning the application of (a) established doctrines of *per se* antitrust liability relating to vertical price-fixing and tying arrangements and (b) the teachings of *Transparent-Wrap Machine Corp. v. Stokes & Smith Co.*, 329 U.S. 637 (1947), to the grant-back provisions in the Chavanoz—ARCT-France agreements.

1. The Vertical Case Decisions Below Are Inconsistent with the Exhaustion Doctrine Developed by This Court in *Adams v. Burke*, *Motion Picture Patents*, *Univis*, and *Aro*.

In the present case, ARCT-France sold to its United States distributors false twist machines that allegedly embodied improvements covered by the patents in suit. Those sales were authorized by reason of the grant by Chavanoz to ARCT-France of the exclusive right to make and sell machines embodying such improvements. Resale of the machines by ARCT-France's United States distributors was also authorized. Nevertheless, the District Court held that all of these sales remained conditional under the patent laws and that, as a result, Chavanoz and DMRC were entitled to control the use of the machines by imposing a production royalty on each pound of yarn processed on the machines.

This holding is directly in conflict with the exhaustion doctrine—that an authorized sale of a patented article by

the patentee or his licensee, as a matter of law, exhausts the patent monopoly and sends the patented article into commerce free of any further claims of the patentee under the patent laws. This exhaustion doctrine has been reiterated by this Court from *Adams v. Burke* in 1873 to *Motion Picture Patents* in 1917 to *Univis* in 1942 to *Aro* in 1964.

In *Adams v. Burke* the patentee granted to an assignee the right to make, sell and use patented coffin lids within a circle whose radius was ten miles having the City of Boston as its center. The defendant purchased coffin lids from the assignee within this ten-mile circle but used the lids outside the circle. The patentee sued for infringement, but this Court rejected the claim:

It seems to us that, although the right of [the assignees] to manufacture, to sell, and to use these coffin-lids was limited to the circle of ten miles around Boston, that a purchaser from them of a single coffin acquired the right to use that coffin for the purpose for which all coffins are used. That so far as the use of it was concerned, the patentee had received his consideration, and it was no longer within the monopoly of the patent. It would be to engraft a limitation upon the right of use not contemplated by the statute nor within the reason of the contract to say that it could only be used within the ten-mile circle. Whatever, therefore, may be the rule when patentees subdivide territorially their patents, as to the exclusive right *to make or to sell* within a limited territory, we hold that in the class of machines or implements we have described, when they are once lawfully made and sold, there is no restriction on their *use* to be implied for the benefit of the patentee or his assignees or licensees.

84 U.S. (17 Wall.) at 456-57 (emphasis in original). Significantly, the Court in *Adams v. Burke* did not inquire into

the patentee's intent—i.e., whether he intended to release the coffin lids for use outside the ten-mile circle.⁷

Motion Picture Patents is often cited for its holding that tying unpatented products to patented products is an unlawful extension of the patent monopoly. In that case, however, this Court also considered the validity of a use royalty imposed pursuant to a notice attached to a patented movie projector that was purchased by the defendant from one who had been granted a license to make and sell projectors under the applicable patent. The notice stated that the machine could be used only upon terms to be fixed by the assignee of the patent. Pursuant to this notice, the assignee sought to collect a use royalty based upon the size of the movie theater using the projector. The defendant refused to pay the use royalty and was charged with infringement.

This Court rejected the infringement claim and held that the attempted use restriction was “plainly void, because wholly without the scope and purpose of our patent laws and because, if sustained, it would be gravely injurious to that public interest, which we have seen is more a favorite of the law than is the promotion of private fortunes.” 243 U.S. at 519. In the present case, the Throwsters con-

⁷ In the courts below, cross-respondents have attacked the exhaustion doctrine by invoking the pronouncement of this Court in *Adams v. Burke*, repeated in subsequent decisions, that the exclusionary rights of manufacture, use and sale afforded a patentee may be separately licensed. The Throwsters have never disputed this, but have consistently maintained that this authority to license separately does not confer upon the patentee immunity from the exhaustion doctrine. There are ways in which the exclusionary rights may be licensed separately. See *Mitchell v. Hawley*, 83 U.S. (16 Wall.) 544 (1872) (purchaser from licensee authorized to make and use, but not to sell, could not use machine); *Wilson v. Sanford*, 51 U.S. (10 How.) 99 (1850) (license only to use patented machine resembles a lease). However, as *Mitchell v. Hawley* demonstrates, it is the right of *sale* which gives rise to the implied *use* rights, and once the patentee or his authorized licensee sells a patented article, the purchaser obtains the full right to use that article for its normal and intended purposes, and the purchaser has no need of an express use license for that article.

In the present case, DMRC and Chavanoz would have been free to assert a separate use right against other false twist machines not sold under license from Chavanoz.

tracted to buy their machines from Whitin or ARCT, Inc., and then were forced to submit to a use restriction imposed by Chavanoz and DMRC. Thus, the decision in *Motion Picture Patents* squarely supports the Throwsters' position that the use restriction is plainly void.

In *Univis*, this Court once again restated the governing principle that "the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold." 316 U.S. at 249. There, the patentee's assignee had licensed another to make and sell lens blanks but attempted to reserve the right to use those lens blanks. This Court struck down the licensing arrangement as unlawful and held that the consideration received in the form of the purchase price for the lens blanks is the total reward for the use of the invention that is authorized by the patent statutes. Once that reward has been received, "the patent law affords no basis for restraining the use and enjoyment of the thing sold." *Id.* at 251.⁸

Since the licensing scheme in *Univis* was established to facilitate resale price fixing, attempts have been made to

⁸ The decision in *Univis* recognized that the issue there presented did not reach the question of contractual rights created as part of the sale transaction itself (the patentee might effect "other stipulations, for royalties or otherwise," so long as they do not "seek to control the disposition of the patented article after the sale." *Id.* at 250). In the present case, however, the restriction by which Chavanoz and DMRC sought to obtain use royalty payments from the Throwsters was effected only after full and unconditional sales by Whitin and ARCT, Inc. These full and unconditional sales are unlike the sales transactions involved in *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), a decision upon which cross-respondents have relied for the proposition that the patentee may, under the patent laws, demand royalties from distant purchasers of industrial machinery based upon use. As made clear in lower court *Brulotte* decisions (this facet of the *Brulotte* case was never addressed by this Court), the patentee sold his goods through a manufacturing agent and received his patent remuneration in the form of royalties agreed to by the purchaser as a part of the initial sales transaction. See *Thys Co. v. Brulotte*, 382 P.2d 271, 273 n.1 (Wash. 1963); *Thys v. State*, 199 P.2d 68 (Wash. 1948).

limit the broad exhaustion holding of *Univis* to cases involving price fixing. See *Armstrong v. Motorola, Inc.*, 374 F.2d 764 (7th Cir.), *cert. denied*, 389 U.S. 830 (1967). However, the most recent reaffirmation by this Court of the exhaustion doctrine appears in *Aro*, a case where no antitrust issues were even raised. In *Aro*, a charge of contributory infringement was asserted against a company that sold fabric to car owners for repair of convertible tops. To determine contributory infringement, this Court found it necessary to determine if the purchasers of the cars were direct infringers in using the fabric. Although Ford, from whom the cars were purchased, initially had no license whatsoever, the Court made clear that a license to Ford to make and sell (but not to use) would have been sufficient to give Ford's customers an absolute right to use:

It is not controverted—nor could it be—that Ford infringed by making and selling cars embodying the patented top-structures without any authority from the patentee. If Ford had had such authority, its purchasers would not have infringed by using the automobiles, for it is fundamental that sale of a patented article by the patentee or under his authority carries with it an 'implied license to use.' *Adams v. Burke* . . . ; *United States v. Univis Lens Co.* . . .

377 U.S. at 483-84. Indeed, when Ford was later licensed to make and sell (but not to use), a specific restriction on replacement of top fabric was held ineffective to limit the complete right to use which the authorized sale conferred:

The contrary provisions in the agreement, purporting to restrict the right of use and repair by prohibiting fabric replacement unless done with fabrics purchased from Ford or some other licensee, stand condemned by a long line of this Court's decisions delimiting the scope of the patent grant. When the patentee has sold the patented article or authorized its sale and has thus

granted to the purchaser an 'implied license to use,' it is clear that he cannot thereafter restrict that use; 'so far as the use of it was concerned, the patentee had received his consideration, and it was no longer within the monopoly of the patent.'

377 U.S. at 497 (citations omitted). In refusing to apply the exhaustion doctrine in the present case, the District Court relied on the facts that ARCT-France was not specifically granted use rights under the patents in suit, that it knew it did not have use rights and that the Throwsters knew of the attempted reservation of use rights by Chavanoz and DMRC. However, the decisions of this Court, particularly the *Aro* decision, establish that it is irrelevant whether the manufacturing and sale licensee was granted the right to use the patented product. So long as the licensee is authorized to sell, that sale confers upon the purchaser the right to use.

In short, the failure of the courts below in this litigation to apply the exhaustion doctrine and thereby to brand "plainly void" the use restrictions imposed by Chavanoz and DMRC is in direct conflict with prior decisions of this Court. This conflict should be resolved to provide certainty in the field of patent rights and patent exploitation, which has been referred to as the law's most lethal minefield. Patent owners, as well as purchasers of patented products, are entitled to a clear definition of the exclusionary rights of manufacture, use and sale and of the limitations imposed on those rights by the exhaustion doctrine.

2. The District Court's Application of *General Talking Pictures* Raises a Sharp Conflict Between That Decision and the Later Decisions of This Court in *Univis* and *Aro*.

In *General Talking Pictures*, this Court held that a patentee may grant a manufacturing licensee a limited, rather than a complete, license to sell, in which case the

licensee is authorized to sell only for certain specified uses, and the patentee may invoke patent rights against the licensee and its purchasers if sales outside the scope of the license are made:

As the [field of use] restriction was legal and the amplifiers were made and sold outside the scope of the license the effect is precisely the same as if no license whatsoever had been granted to Transformer Company. And as Pictures Corporation knew the facts, it is in no better position than if it had manufactured the amplifiers itself without a license. It is liable because it has used the invention without license to do so.

305 U.S. at 127. Justice Black filed a vigorous dissent on the ground that the decision was clearly inconsistent with prior decisions of this Court which held that "when an article described in a patent is sold and 'passes to the hands of a purchaser, it is no longer within the limits of the monopoly....'" 305 U.S. at 128 (citations omitted).⁹

In the courts below, the Throwsters distinguished *General Talking Pictures* on the ground that the license granted in that case was limited to a particular field of use in contrast to the license from Chavanoz to ARCT in the present case which was a full and unrestricted grant of the manufacture and sale rights of Chavanoz.¹⁰ The District Court

⁹ Similarly, the Antitrust Subcommittee of the House Judiciary Committee has concluded that "it is difficult to reconcile the *General Talking Pictures* case with *Adams v. Burke*." Staff of Subcomm. No. 5, House Comm. on the Judiciary, 84th Cong., 2d Sess., Antitrust Problems in the Exploitation of Patents at 19 (1956).

¹⁰ The restrictive covenants whereby ARCT agreed to sell only to Helanca licensees and later only to holders of a Chavanoz process license do not by their terms purport to limit the scope of the patent license granted to ARCT-France and should not be interpreted to do so. Indeed, there is no direct relationship between the restrictive covenants and patents embodied in the machines manufactured and sold by ARCT-France—i.e., the restraints, on their face, apply irrespective of the actual applicability of patents to such machines.

x "1913" was noncommercial customers

rejected this distinction and relied upon *General Talking Pictures* as supporting the use restriction imposed by Chavanoz and DMRC after the authorized sale of machines by ARCT-France and its distributors. This holding creates a direct conflict between *General Talking Pictures* and this Court's later decisions in *Univis* and *Aro*.

Moreover, there is no doubt that the decision in *General Talking Pictures* is out of step with the other Supreme Court decisions discussed above. Significantly, the decision has never been cited by this Court except in support of an extraneous doctrine regarding the Court's powers to review. Indeed, the authoritative endorsement of the exhaustion doctrine in *Univis* and *Aro* strongly suggests that *General Talking Pictures* has been overruled *sub silentio*. The present case highlights the conflict among these Supreme Court decisions. In light of this conflict, it is respectfully submitted that this Court should expressly overrule *General Talking Pictures* or, at the very least, explain the limits of its continuing vitality in light of the subsequent decisions in *Univis* and *Aro*.

3. The Vertical Case Decisions Below Permit the Establishment and Enforcement of a Private Patent System in Contravention of Public Policy and Established Principles of Patent and Antitrust Law.

This Court has consistently held that "the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents but is 'to promote the progress of science and the useful arts'" *Motion Picture Patents*, 243 U.S. at 511. Yet Chavanoz and DMRC have collected millions of dollars in use royalties by licensing a package of 22 patents, all of which have now been held to be invalid or not infringed or both invalid and not infringed. Chavanoz and DMRC were able to reap these private fortunes by constructing a contractual system which unreasonably restrained trade by forcing machine purchasers to sign

production royalty agreements, not because of any voluntary desire to obtain the use of patented technology, or in response to their recognition of the value of that technology or even because of a need for a license, but simply because purchased machines would not be delivered in the absence of an executed "license agreement".

Absent the restraint, the Throwsters could have chosen to sign a license or not and to negotiate its terms, depending upon their perception of the exhaustion doctrine and the strength of the patents in suit. Public policy clearly demands that freedom of choice:

A patentee is given rights to his device, but he is given no power to force it on the world. If the world buy it or use it the world will do so upon a voluntary judgment of its utility, demonstrated, it may be, at great cost to the patentee. If its price be too high, whether in dollars or conditions, the world will refuse it; if it be worth the price, whether in dollars or conditions, the world will seek it.

United States v. United Shoe Machinery Co., 247 U.S. 32, 65 (1918).

In addition, the private patent system erected by cross-respondents enabled Chavanoz to collect royalties in contravention of the principle that "[o]ne royalty to one patentee for one sale is enough under our patent law as written." *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U.S. 336, 360 (1961) (Black, J., concurring). After collecting a full patent royalty from ARCT-France for every machine manufactured and sold by ARCT-France (that royalty being no less for machines sold into the United States where purchasers also paid a use royalty than for machines sold into countries where no use royalty program existed), Chavanoz and DMRC shared the use royalties collected from United States purchasers. As noted previously, over the useful life of a machine these use royalties

could be expected to exceed, or even double or triple, the Throwster's initial outlay for the machine.

The private patent system also enabled Chavanoz and DMRC to fix, by agreement, an element of the total purchase price paid by the Throwsters for false twist machines. As found by the District Court, a Throwster who purchased a machine had to pay an initial purchase price to Whitin or ARCT, Inc. and then had to agree to pay a continuing production royalty to Chavanoz and DMRC in order to obtain possession of the machine and use it for its intended purpose. This production royalty was thus an element of the total consideration or price which the purchaser was required to pay in order to obtain full ownership rights to the machine—i.e., not only title, but also possession and the opportunity to use the machine for its intended purpose—and it was an element which was not negotiable with the seller of the machine.¹¹ Moreover, by written agreement, Chavanoz and DMRC fixed the amount of the production royalty and this amount was not negotiable. These facts bring this case under the precedent of the classic vertical price fixing decisions in which a purchaser was confronted with an irreducible minimum price determined by a third party. See, e.g., *Schwegmann Brothers v. Calvert Distillers Corp.*, 341 U.S. 384 (1951); *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960). Cf. *In re Yarn Processing Patent Validity Litigation*, 541 F.2d 1127, 1136 (5th Cir. 1976), cert. denied, 433 U.S. 910 (1977). Vertical price fixing, of course, has been condemned consistently by this Court as a *per se* violation of the antitrust laws. *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51 n.18 (1977).

¹¹ Indeed, although rejecting the Throwsters' vertical antitrust case, the District Court did find that the production royalties should be deemed an element of the purchase price of the machine. 444 F. Supp. at 673.

Finally, the vertical restraints imposed to effectuate cross-respondents' private patent system provided none of the pro-competitive effects discussed by this Court in *Continental T.V.* as the basis for its holding that vertical customer or territorial restraints should not be held *per se* illegal. To the contrary, and as the Court of Appeals held, the vertical restraints in the present case—in particular restricting machine deliveries to those licensed by DMRC—played a central role in ensuring the maintenance of the parallel licensing programs of cross-respondents and Leeson. Even assuming that those parallel licensing programs were not maintained pursuant to concerted action in violation of the antitrust laws, it is undisputed that the domination of the United States false twist machinery market by only two suppliers presented a classic case of oligopoly and that the vertical restraints facilitated the perpetuation of that oligopolistic market. Under these circumstances, and particularly in the absence of any pro-competitive effects, these vertical restraints should have been held to violate Section 1 of the Sherman Act under the rule of reason.¹² See generally Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. Chi. L. Rev. 1 (1977); Bork, *Vertical Restraints: Schwinn Overruled*, 1977 Sup. Ct. Rev. 171; Strasser, *Vertical Territorial Restraints after Sylvania: A Policy Analysis and Proposed New Rule*, 1977 Duke L.J. 775.

In summary, the private patent system erected by cross-respondents, and the vertical restraints enforced in furtherance of that system, enabled Chavanoz and DMRC to

¹² In addition, the vertical customer restriction whereby delivery was precluded to those who would not pay royalties was supportive of the vertical price fixing scheme described above. As such, it should have been found *per se* illegal under established precedent. *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707, 721 (1944); *Continental T.V. Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51 n.18 (1977).

collect double royalties, resulted in vertical price fixing and perpetuated the oligopolistic false twist market, all in contravention of the fundamental public policy that "competition should not be repressed by worthless patents." *Pope Mfg. Co. v. Gormully*, 144 U.S. 224, 234 (1892).

4. The Vertical Case Decisions Below Raise Significant Questions Concerning the Application of Established Antitrust Principles Relating to Tying Arrangements and Grant-Back Provisions in the Important and Complex Area of Patent Licensing.

The Throwsters contend that cross-respondents' entire licensing system whereby Throwsters, in order to obtain delivery of their ARCT false twist machines, were required to sign the standard DMRC royalty agreement was fraught with practices violative of the antitrust laws under established principles relating to a whole host of areas of antitrust concern. In addition to those already discussed, these antitrust violations include the use of tying arrangements and grant-back provisions in patent licensing agreements whereby cross-respondents were able unlawfully to extend the patent monopoly.⁴ The courts below, however, held otherwise. This petition, the Throwsters submit, presents important questions concerning the application of established principles relating to tying arrangements and grant-backs.

Cross-respondents' practice of tying machines, patents and technical information into a single compulsory package constitutes a tying arrangement of the type long condemned by this Court as a *per se* antitrust violation. *Northern Pacific Railway v. United States*, 356 U.S. 1 (1958); *United States v. Loew's*, 371 U.S. 38 (1962). The vice of such a practice is that the weaker or inapplicable patents draw strength from the compulsory tie, and the separate monopolies of those patents are illegally enlarged in view of precepts laid down in *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 459 (1940).

Under the amply supported findings of the District Court, several different combinations of tying and tied products were involved. The ARCT machines were the tying product for a combination of inapplicable patents, process patents and technical information. Those few patents employed on the machines were an additional lever for forcing a license under process patents (which at most would be applicable only for certain fibers and specific running conditions), as well as under inapplicable apparatus patents and unpatented technology.

Although finding a patent misuse by reason of these tying practices, the courts below concluded that a market did not exist in the tied products because there was no evidence that there were other competitors offering patents or technology in the false twist field, and that there was, therefore, no antitrust violation. However, the courts' analysis, the Throwsters submit, overlooks the peculiar nature of a tie based on patents and would legalize precisely those ties which have the greatest chilling effect on competition. The plain fact is that in the new and expanding false twist industry there could be no alternative purveyors of technical information or patents because defendants were required to take licenses under the Chavanoz/DMRC brand. A tie which totally precludes competition from developing can not logically be deemed less invidious than one which diminishes existing competition.

The rules against tying in a normal (*i.e.* non-patent) context are intended to prevent a party with some market power in one product (typically not monopoly power) from using that power to acquire market power (again, the law does not require that monopoly power be obtained) in the tied product. The primary anticompetitive feature is the tendency of the tie to move the structure of the tied market toward a monopoly. But where the tied product is a patent it might normally be expected that the degree of monopoly power conferred by the patent prevents actual—

as distinguished from potential—competition from developing. The tied market is *already* in a structural condition which is antithetical to the antitrust laws. In the absence of tying conduct the legal nature of a properly exploited patent monopoly precludes antitrust prohibitions from attaching. But when patents are tied to other patents (or to a product as to which the defendant has more power), the result is that the otherwise lawful patent monopoly in the tied product *draws strength* from the tying patents or product, and the existing monopoly of the tying patents is carried beyond the metes and bounds permitted by the patent law. The ruling below—that a doctrine designed to prevent incipient monopoly power is not applicable to an existing monopoly strengthened by the tie—therefore stands antitrust on its head.¹³

In cases such as this where the wrongdoers' very conduct precludes the development of an alternative market for the tied product, the "substantiality" of effect on the tied product—one of the required elements in a tying case—should, the Throwsters therefore submit, be measured by the substantiality of the payments made—i.e., the volume of sales affected by the restraint. Such a measure is a more meaningful analysis of anticompetitive impact and constitutes a standard consistently adhered to by this Court. *See Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495, 502 (1969) ("[T]he relevant figure is the total volume of sales tied by the sales policy under challenge. . . ."); *International Salt Co. v. United States*, 332 U.S. 392, 396 (1947); *United States v. Loew's, Inc.*, 371 U.S.

¹³ It also seems clear that cross-respondents' licensing practices forced Throwsters to take something they did not want. This Court in *United States Steel Corp. v. Fortner Enterprises, Inc.*, 429 U.S. 610 (1977), declared that a tying arrangement imposed by a party with sufficient market power "to require purchasers to accept burdensome terms that could not be exacted in a completely competitive market" is illegal under the antitrust laws. *Id.* at 620. Tying arrangements, like most *per se* illegal violations of the antitrust laws, are condemned because they effectuate monopolistic control of the market and impose the monopolist's will on others. Such is the case here.

38, 49 (1962). Clearly the millions in royalties collected by DMRC on tied products during the four years before litigation (444 F. Supp. at 687 n. 20) is "not insubstantial" and accordingly a *per se* violation of Section 1 should have been found on this additional ground.

The success of cross-respondents in imposing the standard DMRC royalty agreement on every purchaser of ARCT machines was in no small measure aided by the workings of the grant-back provisions in the Chavanoz-ARCT-France agreements. The sheer number of patents in the Chavanoz portfolio, as the evidence shows cross-respondents well recognized, lent an appearance of strength to the package which increased the leverage on the Throwsters. A majority of the patents in suit were issued on ARCT-France inventions which were assigned to Chavanoz via the grant-back. Since DMRC and Chavanoz unilaterally added new patents to the licensed package, the stocking of the Chavanoz patent portfolio through the grant-back provision extended the term of royalty payments (as the District Court interpreted the license agreements) beyond the terms of the patents on Chavanoz's own inventions.

In analyzing the illegality of the grant-back, it must be emphasized at the outset that the Chavanoz-ARCT-France grant-back provisions required the assignment to Chavanoz of all rights and not the mere extension of a non-exclusive license. Courts analyzing such patent grant-back provisions have noted the similarity between a broad grant-back and the tying of technology, patented and unpatented, to individual and limited patent licenses. This basic resemblance to *per se* illegal tying arrangements caused this Court, in *Transparent-Wrap Machine Corp. v. Stokes & Smith Co.*, 329 U.S. 637 (1947) ("*Transwrap*"), narrowly to define the circumstances under which the patent laws allow assignment of technology as consideration for a license of patents. Such limitation hinges on the specific relationship between the basic patent and the improvement patent being granted back (e.g., are they intrinsically

blocking or complimentary patents?). Subsequent decisions, including the decision on remand of the *Transwrap* case, affirmed a desire to limit grant-back technology to patents which are improvements on the basic patent. See *Stokes & Smith Co. v. Transparent-Wrap Machine Co.*, 161 F.2d 565, 567 (2d Cir. 1947).

Here, by contrast, the grant-back was much more sweeping in scope. Not only was Chavanoz's original patent extremely limited, but the grant-back called for return of any and all false twist technology by ARCT-France, whether patentable or not. See 444 F. Supp. at 661-62. Such requirement is tantamount to an agreement not to compete in the development of equipment, whether or not such equipment embodies Chavanoz patents, existing or expired. See *Compton v. Metal Products, Inc.*, 453 F.2d 38 (4th Cir. 1971), *cert. denied*, 406 U.S. 968 (1972).

Assignment grant-backs even narrower than those in this case have long been condemned by the Antitrust Division of the Department of Justice.¹⁴ Because of the impact of the broad grant-back provisions at issue here on the success of cross-defendants' licensing program, the Throwsters submit that this petition presents a significant question as to the application of the *Transwrap* case and an important test of the Antitrust Division's position.

¹⁴ See e.g., Address by Assistant Attorney General McLaren, 5 Trade Reg. Rep. (CCH) ¶ 50,106 (1969) ("We contemplate challenging under Section 1 . . . patent licenses which require an assignment grant-back of all improvement patents"); Allen and Davidow, *Department of Justice Views, in Patent Antitrust 1978* at 12 (P.L.I. 1978).

CONCLUSION

As noted, this petition is a conditional one. The issues presented herein are, at present, not of controlling significance in view of the finding of liability on the horizontal antitrust issues. Cross-respondents, however, will seek review of those horizontal issues by this Court. For the reasons set forth herein, therefore, cross-petitioners pray that, in the event either of the Cross-Respondents' Petitions is granted, this Cross-Petition for a Writ of Certiorari also be granted.

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